Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

March 2020

CONTENTS

BACKGROUND TO THE MARKET PERCEPTIONS SURVEYS

The Central Bank of Kenya (CBK) undertakes a Market Perceptions Survey every two months, prior to every Monetary Policy Committee (MPC) meeting, to obtain perceptions of banks and non-bank private sector firms on selected economic indicators.

The Survey also enables respondents to indicate their levels of optimism in the country's economic prospects and business environment, and perspectives on the current and expected economic conditions, focussing on economic activity and employment. It also captures suggestions by private sector firms on ways to improve the business environment.

Commercial banks, micro-finance banks, and a sample of non-bank private sector firms are included in the surveys. The sample of non-bank private firms, selected from major towns across the country namely Nairobi, Mombasa, Kisumu, Eldoret, Nakuru, Nyeri and Meru, is representative of sectors that account for about 70 percent of real GDP. The sectors covered by the survey include agriculture, mining and quarrying, manufacturing, trade, hotels and restaurants, information and communications technology (ICT), transport, real estate, health, building and construction, and finance and insurance.

The MPC Secretariat conducts sensitisation engagements with respondents on an annual basis in all the regions to facilitate a better understanding of the survey questions, to enhance the quality of responses, and to increase the response rate.

1. INTRODUCTION

The MPC Secretariat carried out the March 2020 MPC Market Perceptions Survey in the first three weeks of the month. The Survey was conducted against the backdrop of the Coronavirus pandemic (COVID-19), which is a significant health and economic shock across the world. The Survey sought perceptions on the economic conditions prevailing in the two months before the MPC meeting, i.e. January and February 2020, and market expectations on economic conditions for March and April 2020, for the next 12 months, (March 2020 – February 2021), and over the medium term. The Survey sought from respondents their expectations with regard to overall inflation, movements of the exchange rate of the Kenya Shilling against the US Dollar, demand for credit, private sector credit growth and economic growth.

Other areas interrogated included the levels of optimism in the economic prospects, perceptions of levels of economic activity before the MPC meeting, expected levels of economic activity after the MPC meeting, and expected levels of employment in 2020.

This report provides a summary of the findings of the Survey.

2. SURVEY METHODOLOGY

The Survey was administered to the Chief Executives and other senior officers of 381 private sector firms comprising 38 operating commercial banks, 1 operating mortgage finance institution, 14 microfinance banks (MFBs) and 328 non-bank private firms including 45 hotels, through questionnaires sent by email and hard copy. The overall response rate to the March 2020 Survey was 65 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 13 micro-finance banks, 35 hotels, and 159 other non-bank private sector firms.

The expectations from commercial and microfinance banks were aggregated and analysed using weighted averages based on the market size of the bank/ microfinance bank relative to total banks/ microfinance banks, respectively, while those from the non-bank private firms were weighted using the respective sector weights based on the latest available sectoral contributions to GDP.

3. HIGHLIGHTS OF THE SURVEY

The Key takeaways from the March 2020 Market Perceptions Survey included:

- Inflation expectations remained well anchored within the target range in the next 2 months and over the next 12 months;
- Respondents expected a weakening bias for the exchange rate of the Ksh/USD over the next 2 months;
- Banks expected a slower pace of increase in private sector credit growth in 2020;
- Expectations of a slower economic growth in 2020, mainly due to the COVID-19 pandemic;
- Moderated optimism on Kenya's economic prospects by banks and non-bank private sector; and
- Significant drop in forward hotel booking relative to the similar period last year.

4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

The March 2020 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in the two months prior to the March MPC meeting, i.e., January and February 2020, to get a sense of the economic conditions prevailing before the MPC meeting.

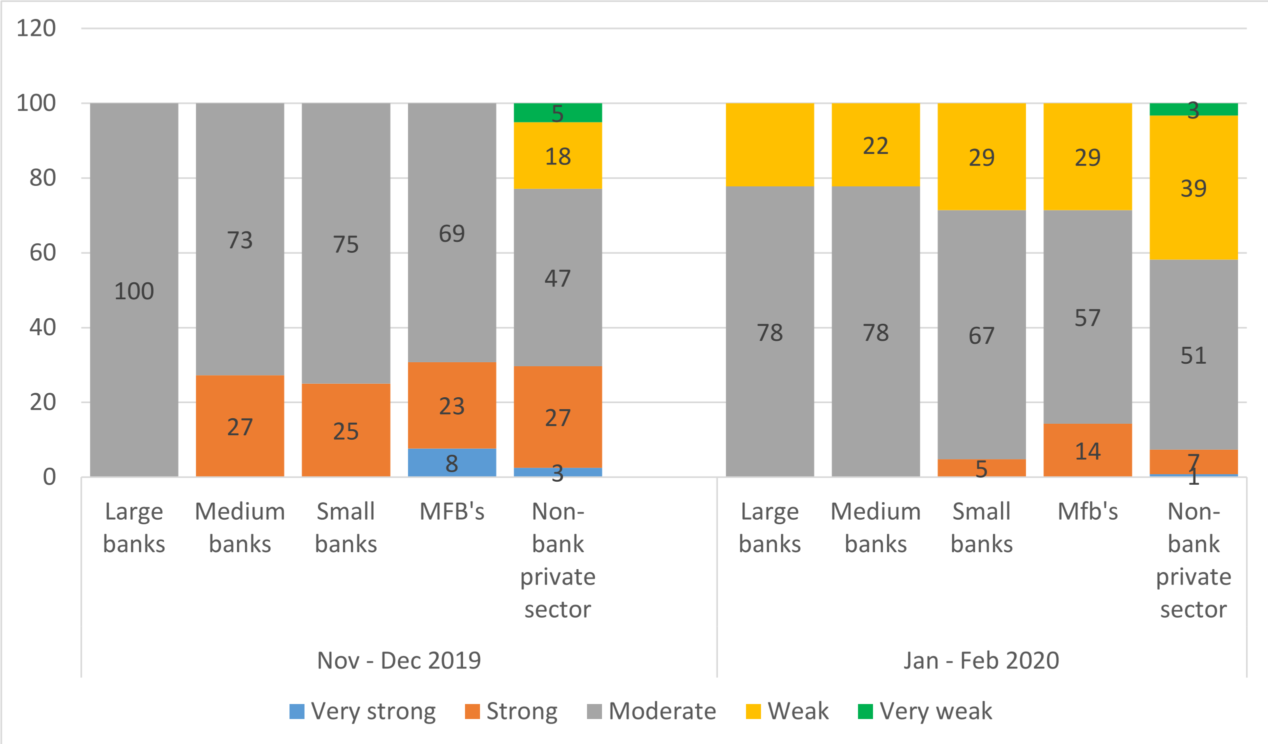
While the results showed expectations of moderate activity in January and February 2020, more respondents indicated weaker activity compared to the previous survey **(Chart 1).** Respondents attributed the weaker activity mostly to the COVID-19 pandemic, which had led to lockdown of many countries, restricting movement of people and hence adversely disrupting travel, trade, manufacturing and the tourism. Other factors mentioned as slowing down activity during this period included low Government spending, the locust invasion and delays in the payment of the pending bills to suppliers by National and County Governments.

In addition, businesses across the sectors reported weak consumer demand, arising from low liquidity levels and disposable incomes, and as a result moderated private consumption.

Equity markets remained subdued due to sell offs by local and foreign investors, while hotels reported massive cancellation of bookings due to the coronavirus. Respondents indicated slow growth in credit to the private sector despite the lifting of interest rate caps.

During this time, however, international oil prices declined and the extended short rains brought some relief to inflation as prices of fast growing food crops fell, supporting economic activity.

Chart 1: Perceptions on Economic Activity in January and February 2020 relative to November and December 2019 (percent)



5. INFLATION EXPECTATIONS

In the Survey, participants provided their expectations of overall inflation rates for the next 2 months (March and April 2020), the next 12 months (March 2020 to February 2021), the next 2 years (March 2020 to February 2022) and the next 5 years (March 2020 to February 2025).

The results showed that respondents expected inflation to remain stable and within the target range (5 ± 2.5 percent) in March and April 2020 **(Chart 2)**.

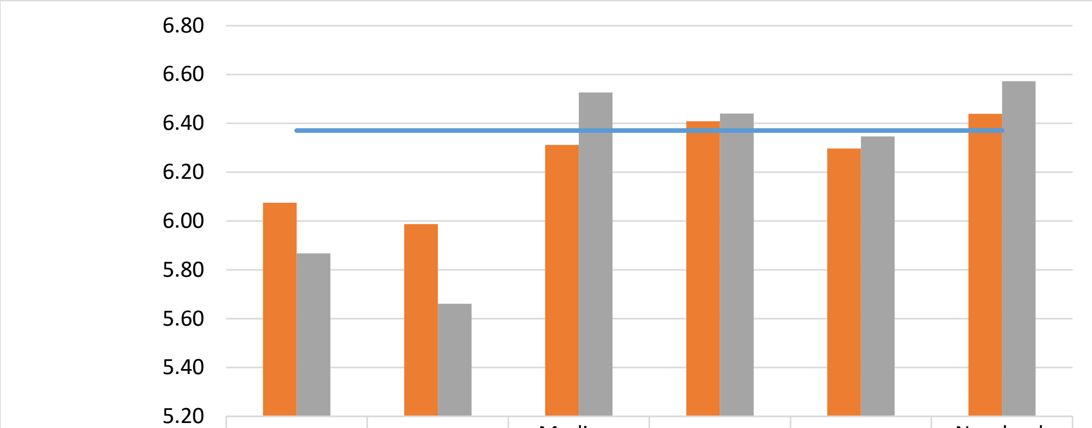
Bank respondents expected a lower inflation in the next two months compared with the February inflation due to lower prices of vegetables resulting from increased supply following good rainfall so far in the first quarter of the year, and lower international oil prices.

However, bank respondents cited disruptions of supply of raw materials due to the COVID-19 pandemic as likely to lead to price increases of manufactured commodities, while the destruction of food crops by locusts in the country may lead to low food production, keeping prices elevated.

The non-bank private sector respondents also expected some upward pressure on inflation to come from supply chain disruptions due to restrictions related to COVID–19 pandemic, and the crop destruction caused by the locust invasion, which could cause excess demand and lead to increased prices for some commodities. In addition, they indicated that there was insufficient supply of maize, which was keeping the prices elevated.

The respondents however expected the onset of rains to ease pressure on food prices and for counteractive measures by Government to address the supply chain disruptions to support low inflation.

Chart 2: Inflation expectations for the next 2 months (percent)



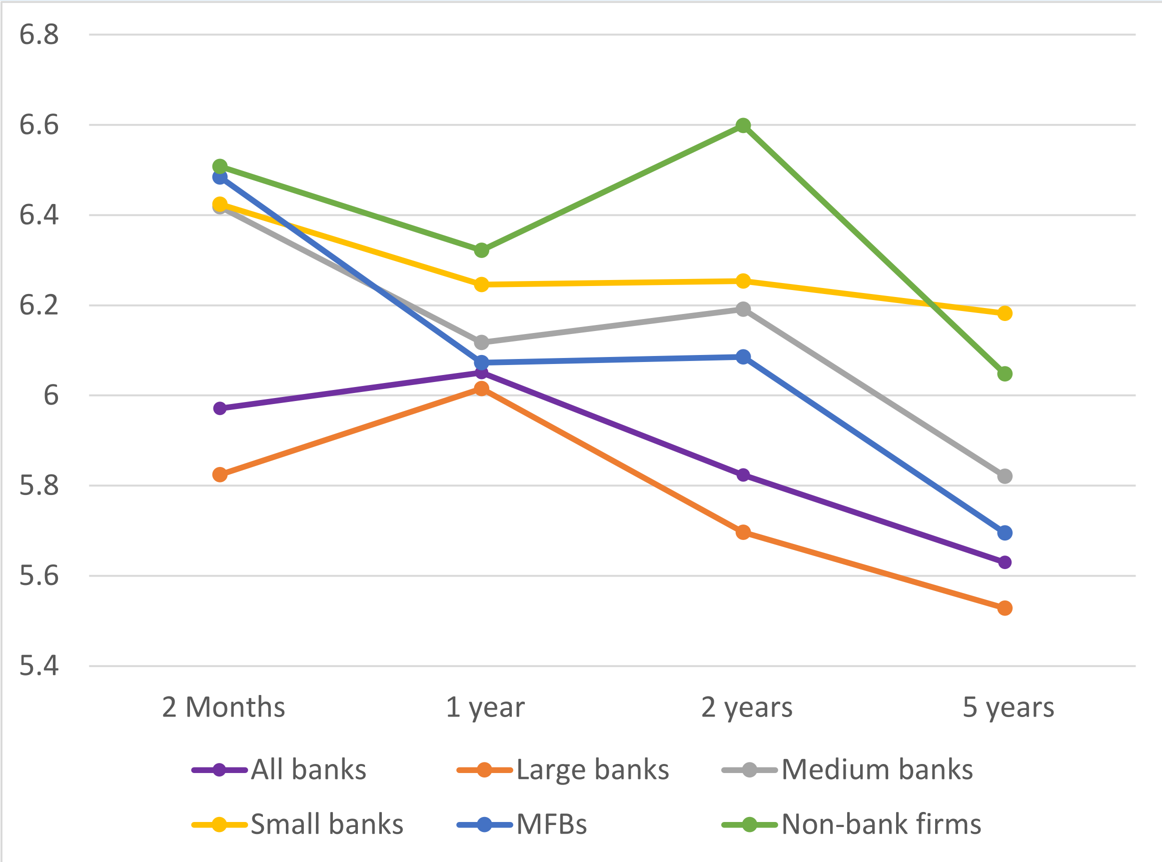
	All banks	Large banks	Medium banks	Small banks	MFB's	Non-bank firms
Mar-20	6.07	5.99	6.31	6.41	6.30	6.44
Apr-20	5.87	5.66	6.53	6.44	6.35	6.57
Feb-20 Actual	6.37	6.37	6.37	6.37	6.37	6.37

Similarly, respondents expected inflation to remain within the target band over the next 1, 2 and 5 years **(Table 1 & Chart 3)**.

Table 1: Inflation expectations (%)

	Inflation expectations for the next			
	2 Months	1 year	2 years	5 years
All banks	6.0	6.1	5.8	5.6
Large banks	5.8	6.0	5.7	5.5
Medium banks	6.4	6.1	6.2	5.8
Small banks	6.4	6.2	6.3	6.2
MFBs	6.5	6.1	6.1	5.7
Non-bank firms	6.5	6.3	6.6	6.0

Chart 3: Inflation expectations (%)



Respondents expected effective monetary policy to keep inflation well anchored within the target range over the next 1, 2 and 5 years.

Respondents expected the low international oil prices and improving food prices due to favourable weather conditions to keep inflation low in the next 1 year. Possible risks to inflation over the medium term included pre-election and election period spending, fluctuating global oil prices and unpredictable weather.

6. EXCHANGE RATE EXPECTATIONS

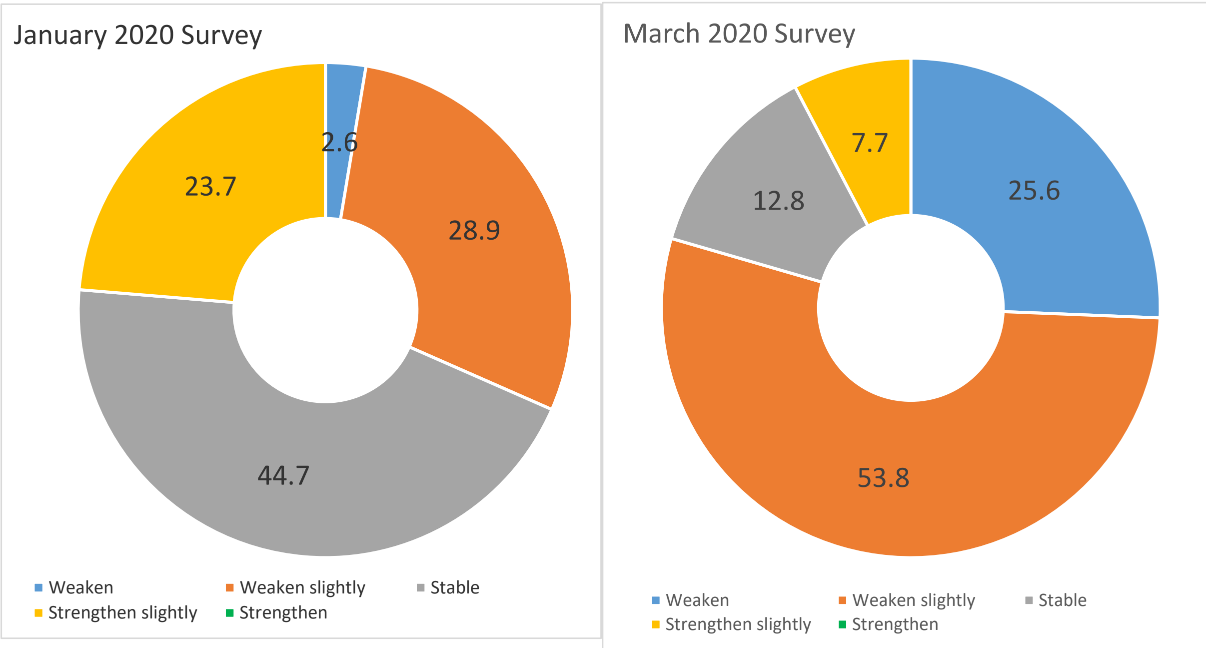
The Survey sought to find out the market expectations on the direction of change in the exchange rate of the Shilling against the US Dollar in March and April 2020.

The results showed that bank respondents expected the Shilling to weaken slightly against the USD in the next 2 months due effects of the COVID-19 pandemic such as increased demand for foreign currency by foreigners selling off stocks and decline in earnings from tourism, aviation and export sectors **(Chart 4)**.

Other reasons included higher prices paid by importers sourcing goods and raw materials from alternative markets, higher shipping costs due to shortage of vessels, dividend and external debt repayments.

However, respondents indicated that adequate foreign exchange reserves, diaspora remittances and subdued demand for the US dollar due to lower imports, and international oil prices would support the Shilling in the next 2 months.

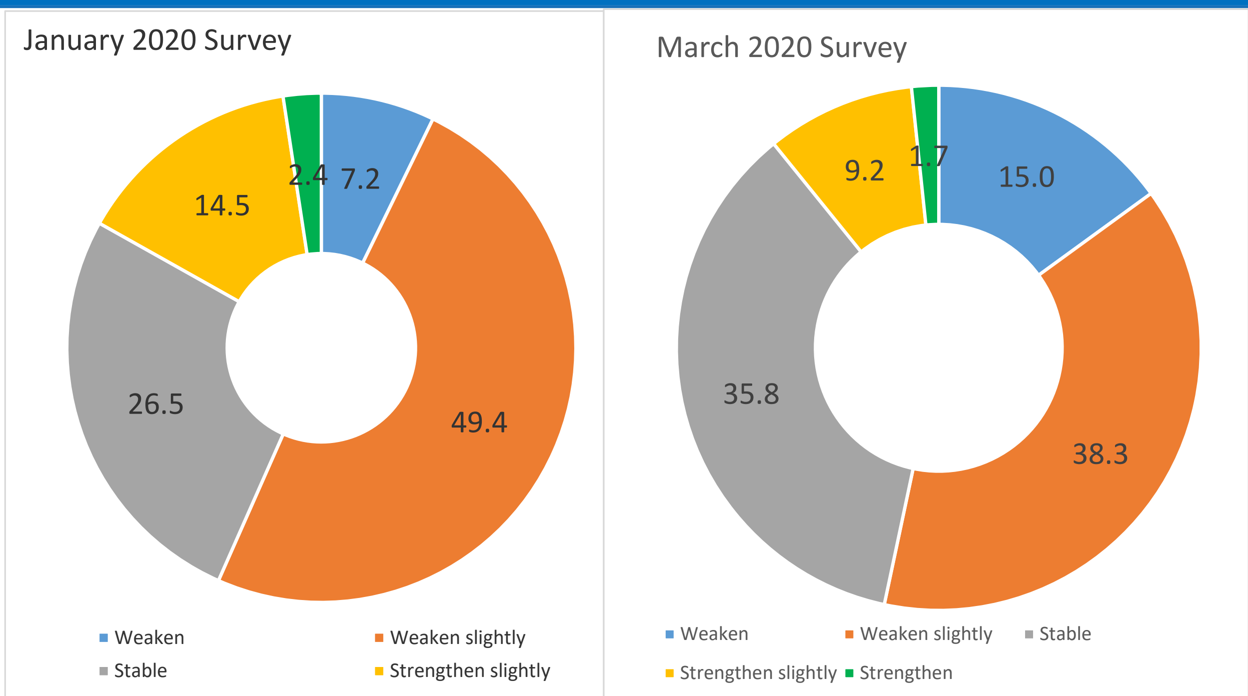
Chart 4: Banks expectations on the direction of the Shilling/ USD Exchange rate in the next 2 months



Non-bank private sector firms expected the Shilling to weaken slightly against the US Dollar in the next 2 months largely due to factors associated with the COVID-19 pandemic (Chart 5). Respondents expected that the lockdown and uncertainty around the pandemic would paralyze tourism and travel and disrupt supply chains mainly from China and other affected countries, leading to importers sourcing products from other suppliers who may be more expensive. In addition, respondents cited lower export earnings, panic selling of stock at the stock exchange, capital flight, speculative hoarding of US dollars and external debt obligations as reasons for the expected weakening of the Shilling.

Respondents however, expected that the sufficient foreign exchange reserves, healthy diaspora remittances and low international oil prices would support the Shilling in the next 2 months.

Chart 5: Non-bank private sector firms' expectations on the direction of Shilling/ USD Exchange rate in the next 2 months



7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

7.1 Growth in Private Sector Credit in 2020

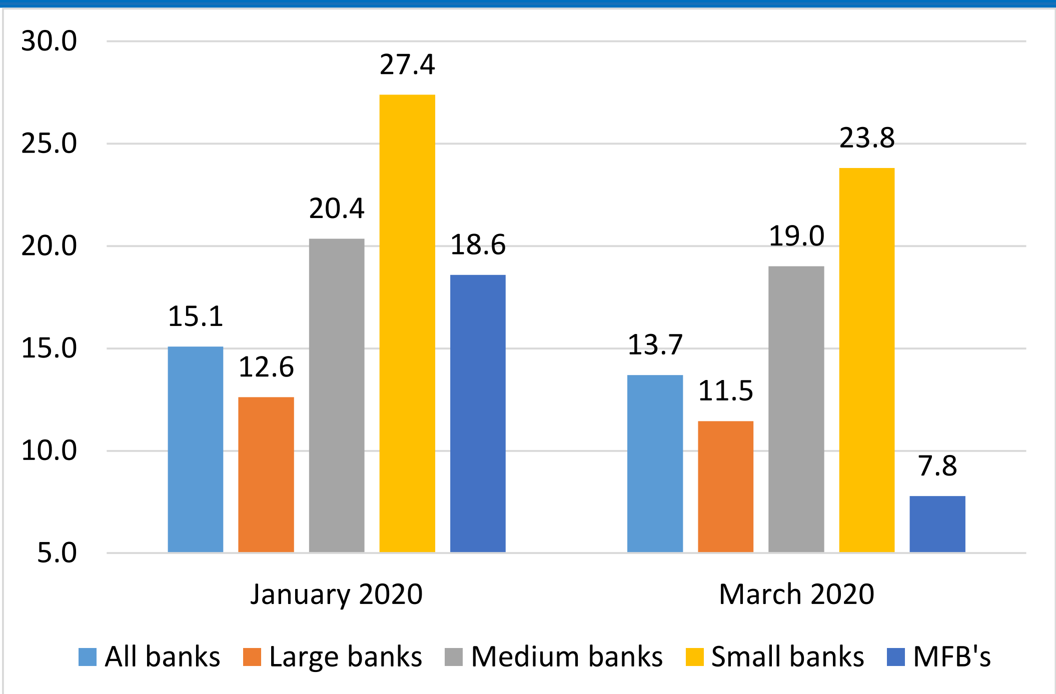
The Survey sought to find out from commercial banks by what percentage they expected to grow credit to private sector by the end of 2020 relative to the position at the end of 2019.

Bank respondents expected credit to the private sector to grow subject to a fast containment of the COVID-19 pandemic, but revised downwards their expectations due to uncertainties surrounding the pandemic, preferring to remain cautiously optimistic with regard to lending **(Chart 6)**.

Respondents expected that credit to the private sector would be driven by increase in demand after repeal of interest rate capping, more focus on lending to MSMEs, favourable weather, improvement in business environment, innovative MSME credit products, ability to price for risk and settlement of pending bills by National and County Governments.

Respondents indicated that the negative impact of COVID-19 on businesses through supply chain disruptions, travel bans and general lockdown would stifle the expected growth in credit to private sector. The impact of locust invasion on agricultural based enterprises and individual borrowers, unpredictable weather patterns, slowdown in Government spending, and scaling down or winding up of certain large entities which in turn impact on entire value chain were also mentioned as factors that would impede credit growth. Additionally, respondents cited non-performing loans and challenges in some sectors such as the real estate sector, which has an oversupply in an environment of diminishing purchasing power as factors that would slow down credit to the private sector in 2020.

Chart 6: Expectations on Private Sector Credit Growth (percent)

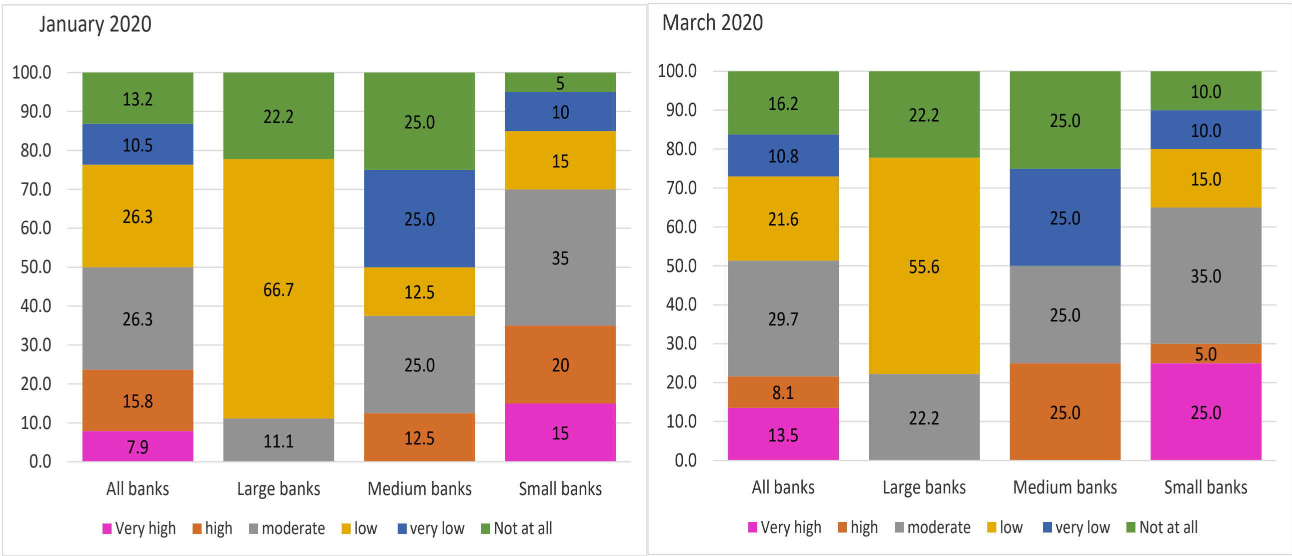


7.2 Role of Liquidity on Private Sector Credit Growth

The Survey asked bank participants to indicate the extent to which liquidity was a constraint to private sector lending for their banks.

The results showed that liquidity was more a constraint to private sector lending in the March survey, relative to the January survey **(Chart 7).**

Chart 7. Extent to which liquidity is a constraint to private sector lending (percent)



The March survey results showed that liquidity was more of a constraint to lending by small banks compared with the medium and large banks. Respondents cited a mismatch between liabilities and assets maturities, inability to issue long-term loans due to short-term deposits, capital constraints, expensive deposits and investments in Government paper as reasons for the inadequate liquidity.

Large and medium banks, however, maintained that they had adequate liquidity but mentioned that averseness to risk was a bigger constraint to lending than liquidity. They indicated that there was sufficient cash from Government payments in the market, and that liquidity was ample. Respondents cited strong customer bases and tight controls by banks as measures taken to ensure that banks had enough deposits to meet borrowing demands.

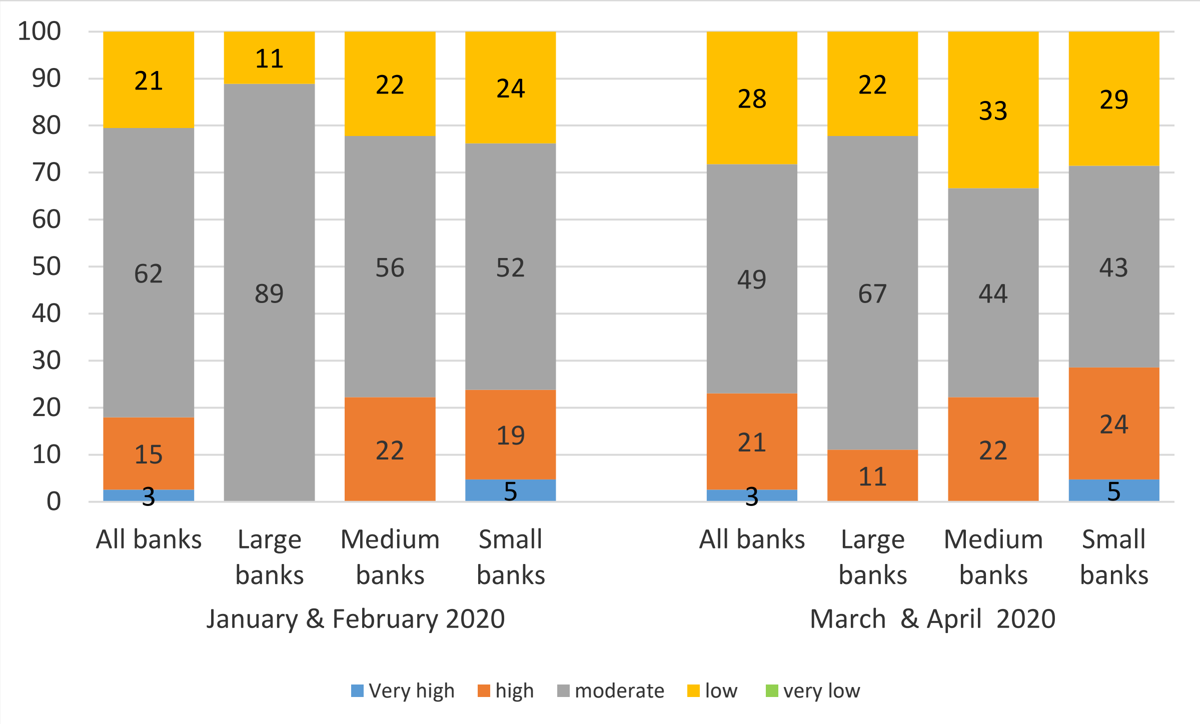
7.3 Expectations of Demand for Credit from banks

The Survey requested bank participants to give an assessment of the demand for credit experienced by their banks in the 2 months before the MPC meeting, i.e., January and February, and their expectations of the same for March and April 2020. The results showed that large tier banks expected increase in credit demand in March and April 2020, while the medium and small tier banks expected a slight decline in credit demand relative to that experienced in January and February 2020 **(Chart 8)**. However, all banks expected moderate to high demand for credit in March and April.

Bank respondents expected improved access to credit, cheaper cost of credit, ease of doing business and payment of pending bills to support credit demand in March and April.

Respondents however indicated that the ongoing disruptions of supply chains related to the COVID-19 pandemic would slow business activity especially in hotels, airlines, manufacturing and trade, leading to reduced demand for credit. Additionally, respondents cited the muted outlook on growth due to the COVID-19 and locust invasion, and the unpredictable weather patterns as factors that would slow down economic activity and hence demand for credit.

Chart 8: Credit demand perceptions for January and February 2020, and expectations for March and April 2020 (percent)



8. ECONOMIC ACTIVITY AND EMPLOYMENT EXPECTATIONS

8.1. Expected Economic Activity

The Survey sought to find out expected levels of economic activity in March and April 2020 by banks and non-bank private sector firms.

Respondents expected subdued economic activity in March and April largely due to the COVID-19 pandemic, indicating possible supply side disruptions with regard to stock level replenishing, slowdown of construction and development projects, longer lead time for imported raw materials, destabilised exports and a contraction of the tourism sector **(Chart 9)**.

Respondents also expected contraction of agricultural production due to the locust invasion.

Other reasons given for the lower activity included delayed payment of pending bills, weak domestic demand, unpredictable weather patterns and potential full economic lockdown due to the COVID-19 pandemic.

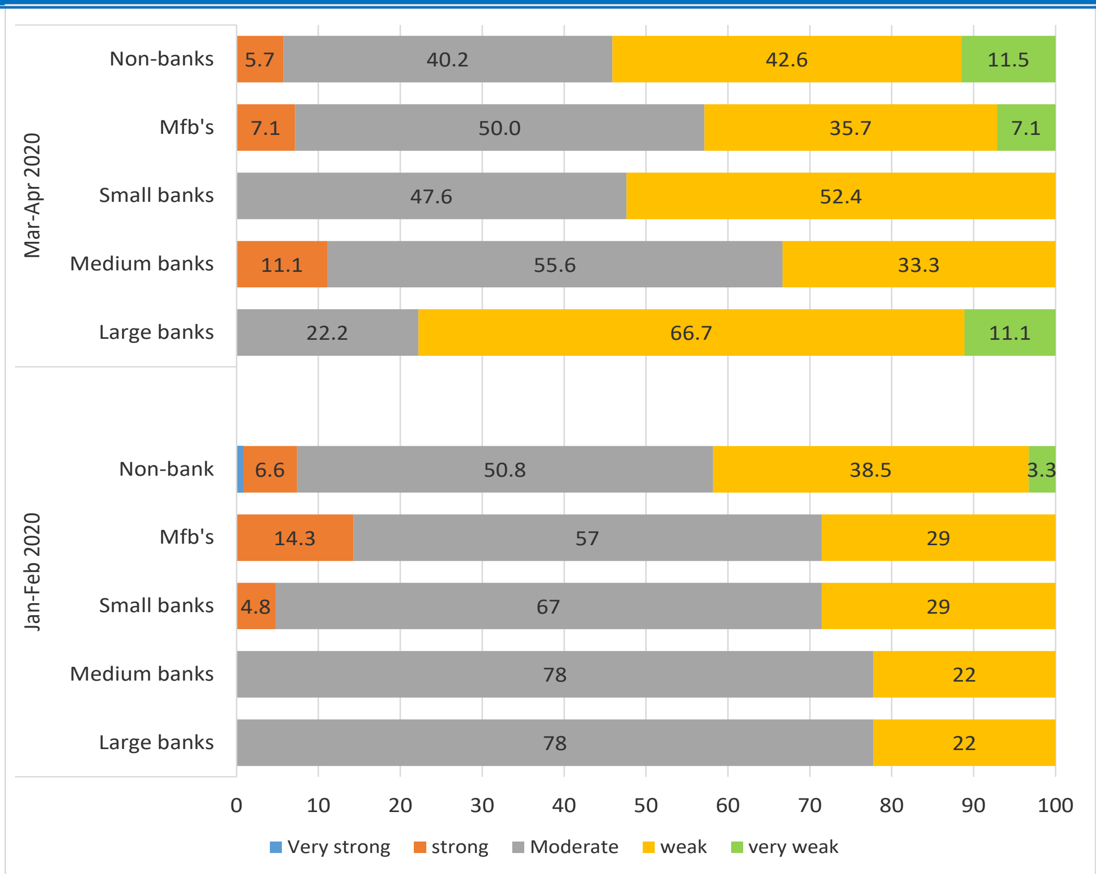
However, respondents expected the realignment of Government budget to tackle emerging threats, the onset of long rains to support agriculture and increase in private sector credit would support economic activity in March and April 2020.

8.2: Operations level & Employment Expectations by banks

The Survey asked bank respondents their level of operation (percent), and expectations with regard to the number of employees the company expected to have in 2020 relative to 2019.

Most commercial banks indicated that they were operating at full potential **(Chart 10).** Those that were not, however cited the unavailability of approved risk based pricing models, capital and liquidity constraints, growth of NPLs and slow NPL recovery, low customer deposits, moderate demand for credit, a subdued business environment, disruptions from global COVID-19 pandemic, slowdown in economic growth and global uncertainties as reasons for operating below capacity.

Chart 9: Expected Economic Activity in March and April 2020 (percent)



Given their levels of operation, most banks expected to either maintain or increase their current numbers of employees in 2020 **(Chart 11),** in line with banks strategies to meet expanding operations, opening of new branches, increased product ranges, acquisitions, need to increase lending, and need to improve efficiency.

Banks however indicated that they would continue with digital optimization even as they built new capacities and increased service levels in areas of innovation.

Chart 10: Current Bank Operation levels (percent)

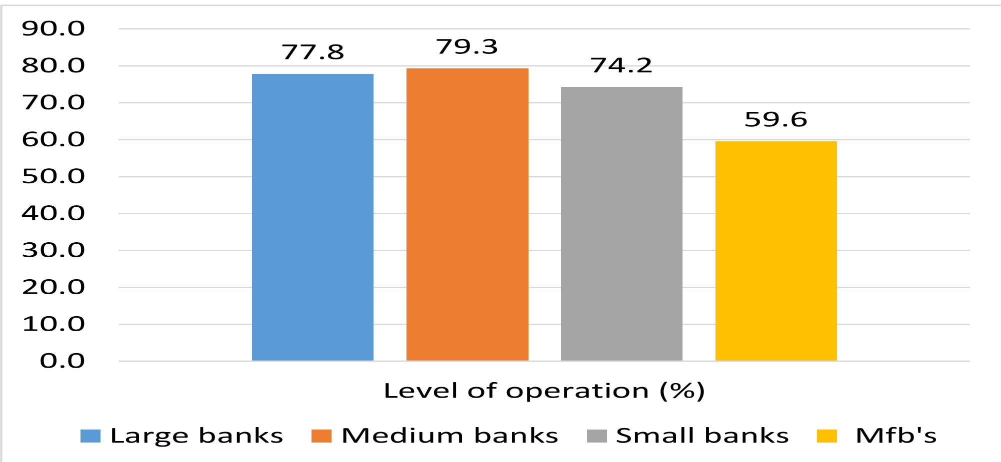
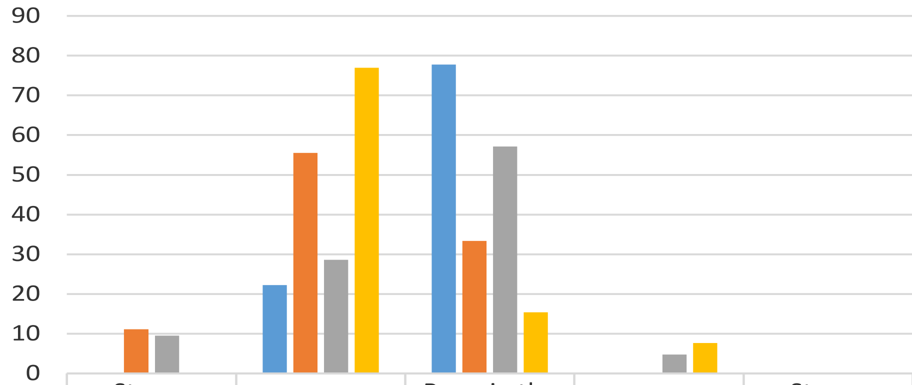


Chart 11: Expected changes in employment levels by banks in 2020 (percent)



	Strong Increase	Increase	Remain the same	Decrease	Strong decrease
Large banks	0	22.2	77.8	0	0
Medium banks	11.1	55.6	33.3	0	0
Small banks	9.5	28.6	57.1	4.8	0
Mfb's	0	76.9	15.4	7.7	0

Large banks Medium banks Small banks Mfb's

8.3: Operations level, Change in capacity utilization & Employment Expectations by non-bank private sector (percent)

The Survey inquired from non-bank private sector respondents about their levels of operation (percent), the change in capacity utilization in 2020 relative to 2019, and expectations with regard to the number of employees the company expected to retain in 2020 relative to 2019.

The tourism sector reported the lowest levels of operation due to low occupancy levels arising from the effects of the COVID-19 pandemic which disrupted the sector due to the lockdowns by countries, travel bans and massive cancellations **(Chart 12)**. The agricultural sector respondents also had low operations levels mostly because of the travel bans affecting exports, in addition to the locust invasion.

Respondents from the manufacturing sector cited reduced supply of raw materials, high cost of production, reduced demand, increased competition especially from products from neighbouring countries, influx of imports at lower prices, due to more favourable manufacturing environments in countries of origin, and counterfeits. In addition, respondents cited high taxation and general slowdown in economic activity as reasons for their operational levels.

According to the Survey, and with the exception of the finance and insurance sector, capacity utilization so far in 2020 was mostly lower than in the previous year **(Chart 13)**. Hotel respondents experienced massive cancellations owing to the pandemic. Factors such as low disposable income, job losses, travel bans, market shutdowns and reduced demand were cited as reasons for the reduced capacity utilization.

Given the decline in capacity utilization and the challenging business environment due to the COVID-19 pandemic, most respondents expected to either retain their current employees, or reduce the numbers **(Chart 14)**. Respondents from hotels indicated that with the low volumes, all employees on contract and those on casual terms would have to be declared redundant, while other respondents expected that their staff numbers would not be sustainable for long if demand did not pick up.

Other respondents expected to reduce their staff levels in order to cut costs and leverage on technology.

Chart 12: Current Non-bank private firms Operation levels (percent)

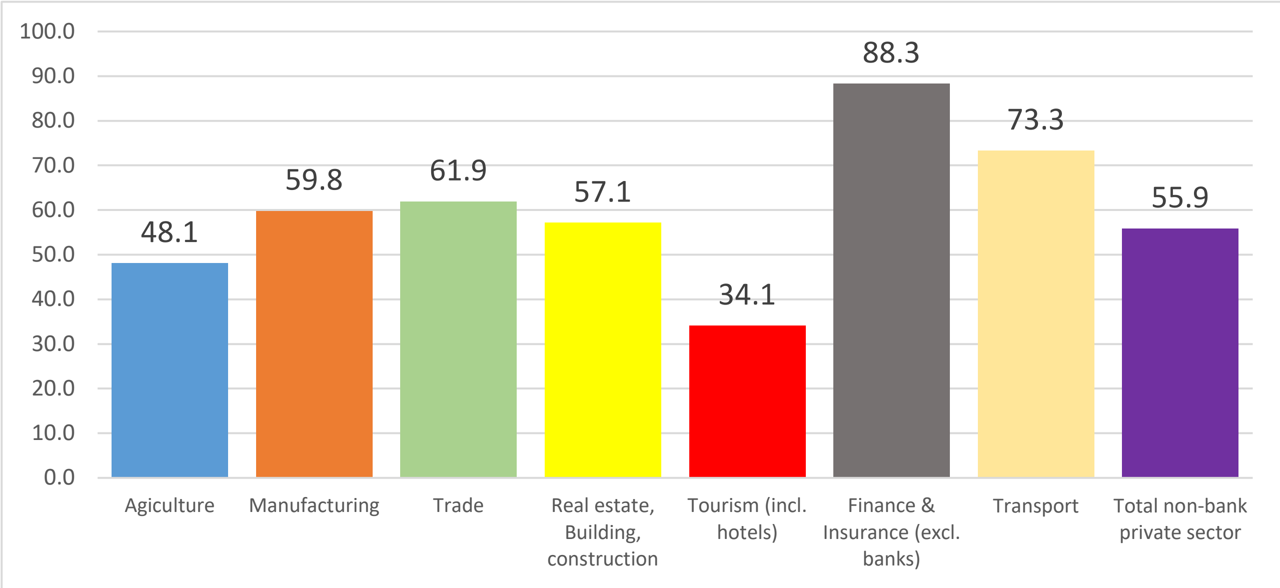


Chart 13: Capacity Utilization by Non-bank private firms in 2020 relative to 2019 (percent)

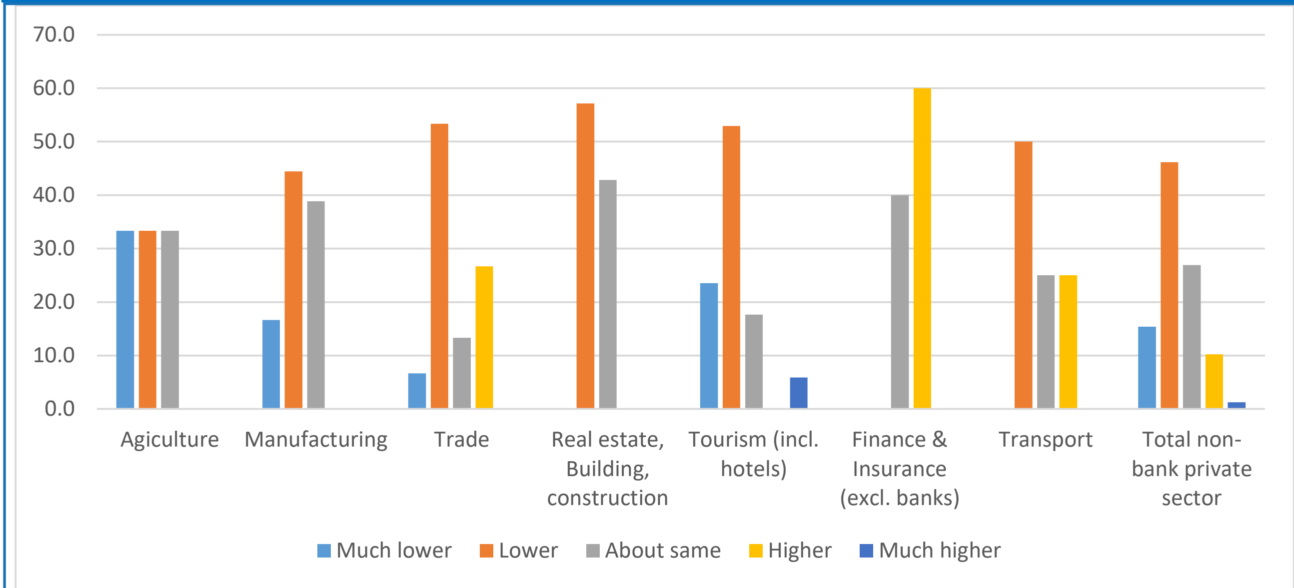
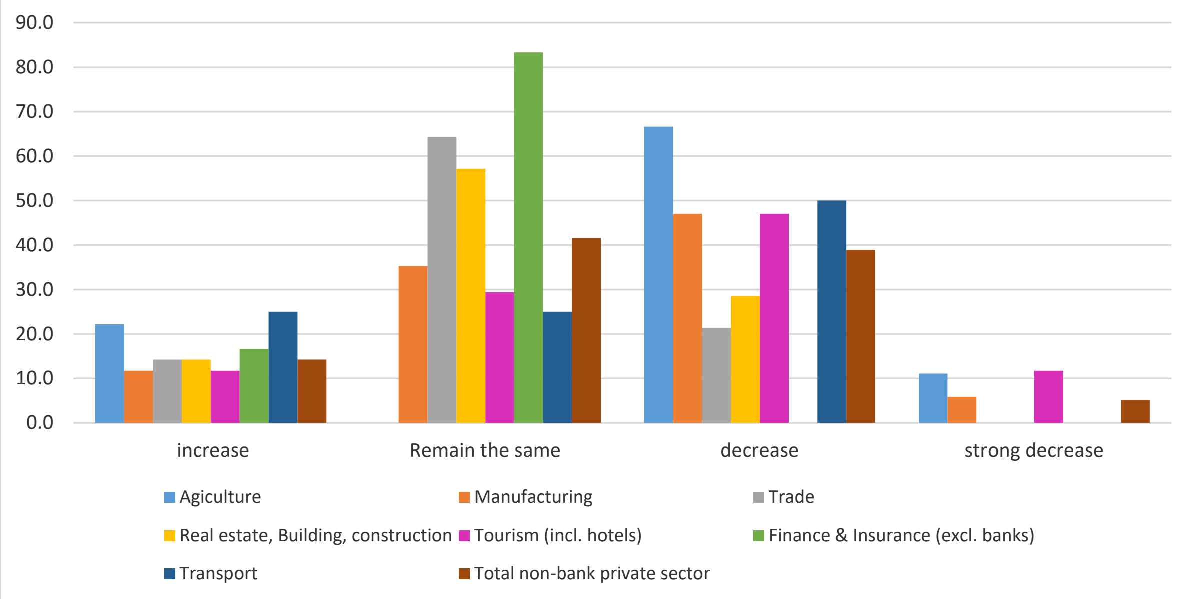


Chart 14: Expected changes in employment levels by non-bank private firms in 2020 (percent)



9. ECONOMIC GROWTH EXPECTATIONS

The Survey requested participants to indicate their expected economic growth rate for the country for the next one, two and five years.

9.1: Economic Growth Estimate for 2020

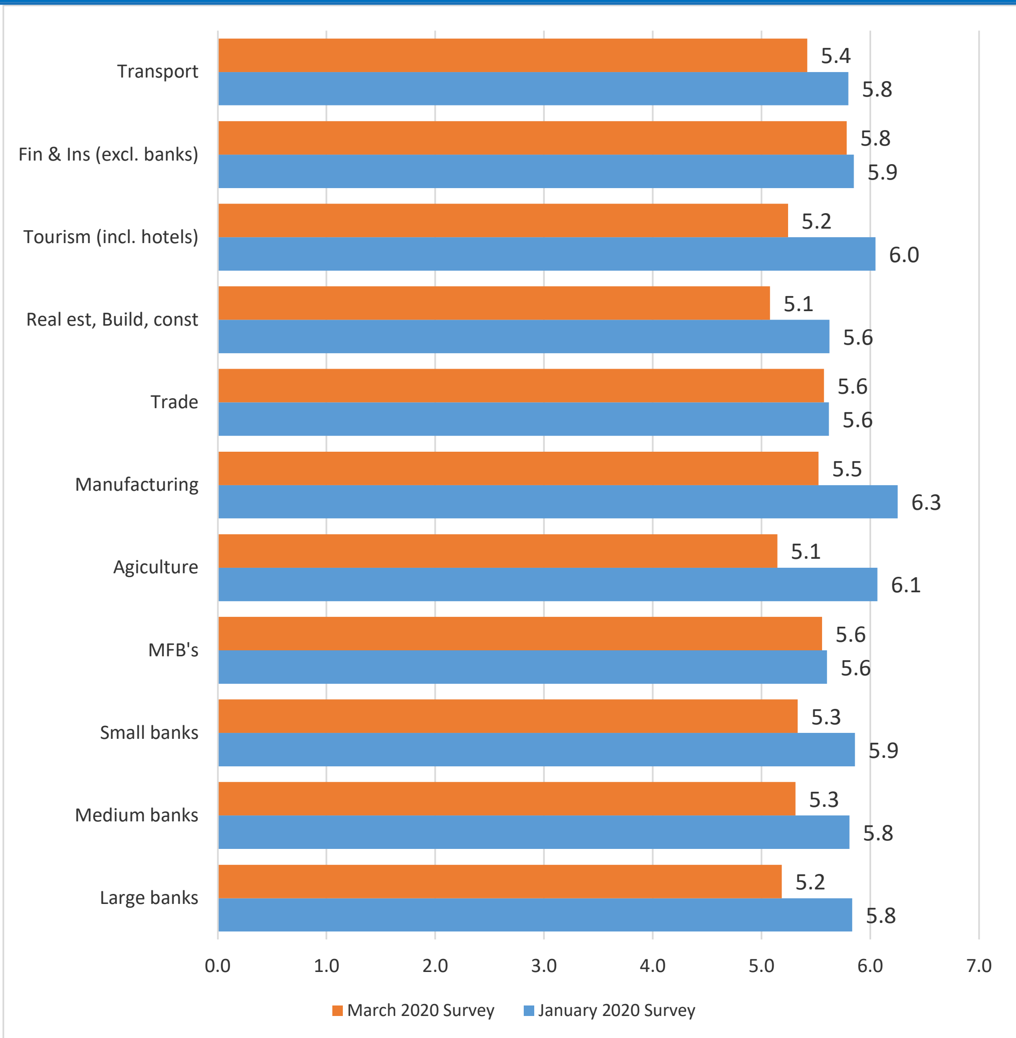
Respondents revised downwards their expectations on economic growth for 2020 largely due to the impact of COVID-19 pandemic on various economic sectors including, tourism and transport, as well as the impact of the locust invasion on agricultural output **(Table 2),(Chart 15)**. Other factors cited as likely to dampen growth in 2020 included fiscal consolidation that would reduce Government expenditure, weak domestic demand, non-performing loans, political noise and global recession.

Respondents expected that it would take a while for trade, travel and investments to pick up after the epidemic was contained, and hence the lower expectations on 2020 growth. However, respondents expected that stimulus actions by the Government will see the economy gradually recover, supported by agricultural production, expanding private sector credit, public investment in infrastructure and the fight against corruption.

Table 2: Expectations on Economic Growth for 2020 (percent)

Survey month	Large banks	Medium banks	Small banks	All banks (Weighted by size of bank)	Micro-finance banks	Non-bank private firms
Jan-20	5.6	5.8	5.5	5.6	5.5	5.5
Mar-20	5.2	5.3	5.3	5.2	5.6	5.3

Chart 15: Expectations on Economic Growth for 2020 across Sectors (percent)

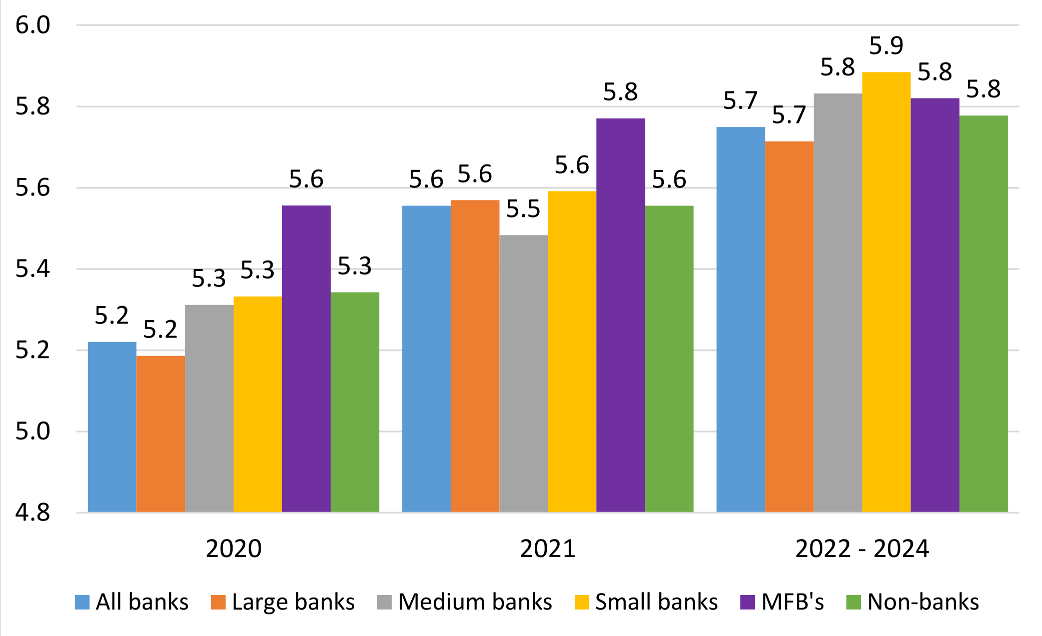


9.2: Economic Growth expectations for 2021 - 2024

Respondents expected the economy to pick up gradually after 2020 in the aftermath of COVID-19 pandemic **(Chart 16)**. Respondents expected the COVID-19 pandemic and locust invasion to be contained and solutions arrived at soon, and for economic growth to pick up from 2021 driven by, among other factors, favourable agricultural production, public investment in infrastructure, increased lending to private sector and continued macroeconomic stability.

However, respondents cited political risk ahead of the elections, stringent spending controls and fiscal consolidation as factors that could soften economic growth in the next few years.

Chart 16: Expectations on Economic Growth 2020 – 2024 (Percent)



10. OPTIMISM ON THE ECONOMIC PROSPECTS

10.1. Economic Prospects

The March 2020 Survey, requested banks and non-bank private sector firms to indicate how optimistic/ pessimistic they were regarding the country's economic prospects. The results showed downward revisions in optimism by respondents across banks and nonbank private sector firms **(Charts 17 and 18)**.

Bank respondents revised downwards their optimism for the country's economic prospects largely due to the adverse effects of the COVID-19 pandemic, which had brought some sectors including tourism, travel, export, imports, etc., to a near standstill, in addition to the locust invasion in the country, which could negatively affect agricultural output in 2020.

Some respondents, however, were optimistic that the renewed focus on agriculture and MSMEs, expectations of favourable weather, low energy costs, private sector credit growth, continued inflows from diaspora, improved ease of doing business, payment of pending bills, continued war on graft and political stability would support growth going forward.

Similarly the non-bank private sector firms revised downwards their optimism levels about the country's economic prospects going forward largely due to the COVID 19 pandemic and locust invasion in the country, citing the uncertainties surrounding the COVID 19 pandemic, the inability to predict the effect of the coronavirus, the travel advisories and possible lockdown of the country.

Other factors cited for these optimism levels included concerns over the external debt obligations, low revenue collection, weak demand, and political noise.

However, respondents expected that improving agriculture due to good weather, Government spending on infrastructure, decline in international oil prices, access to credit and the fight against corruption will surpport economic growth.

Chart 17: Optimism by Banks on Economic Prospects, Going Forward (percent)

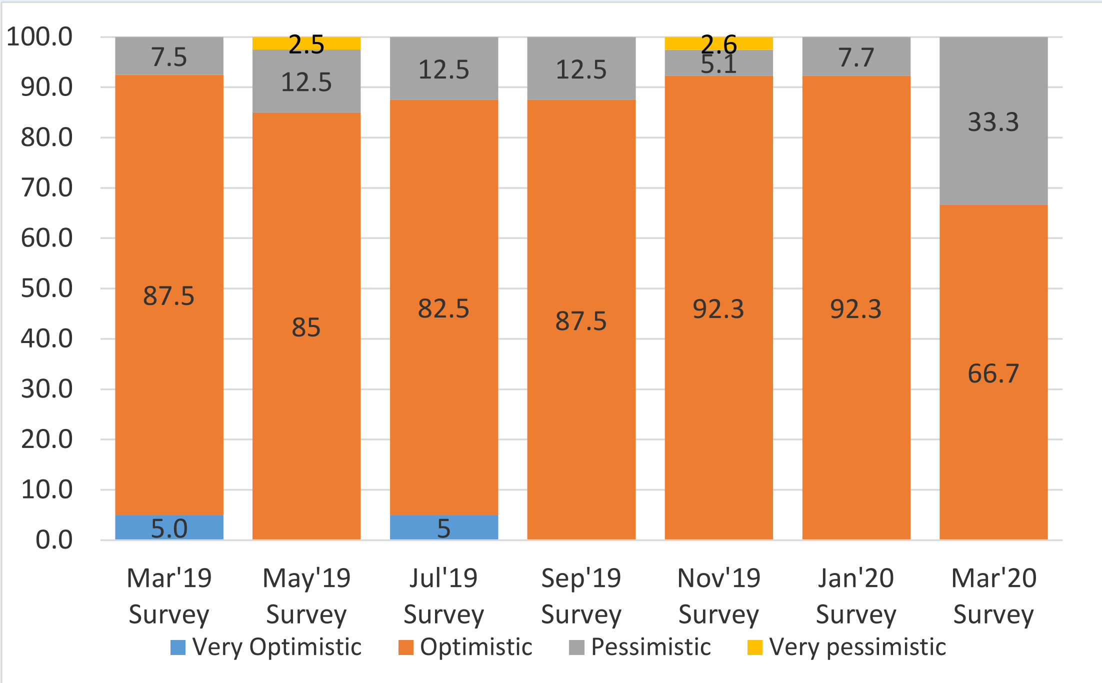
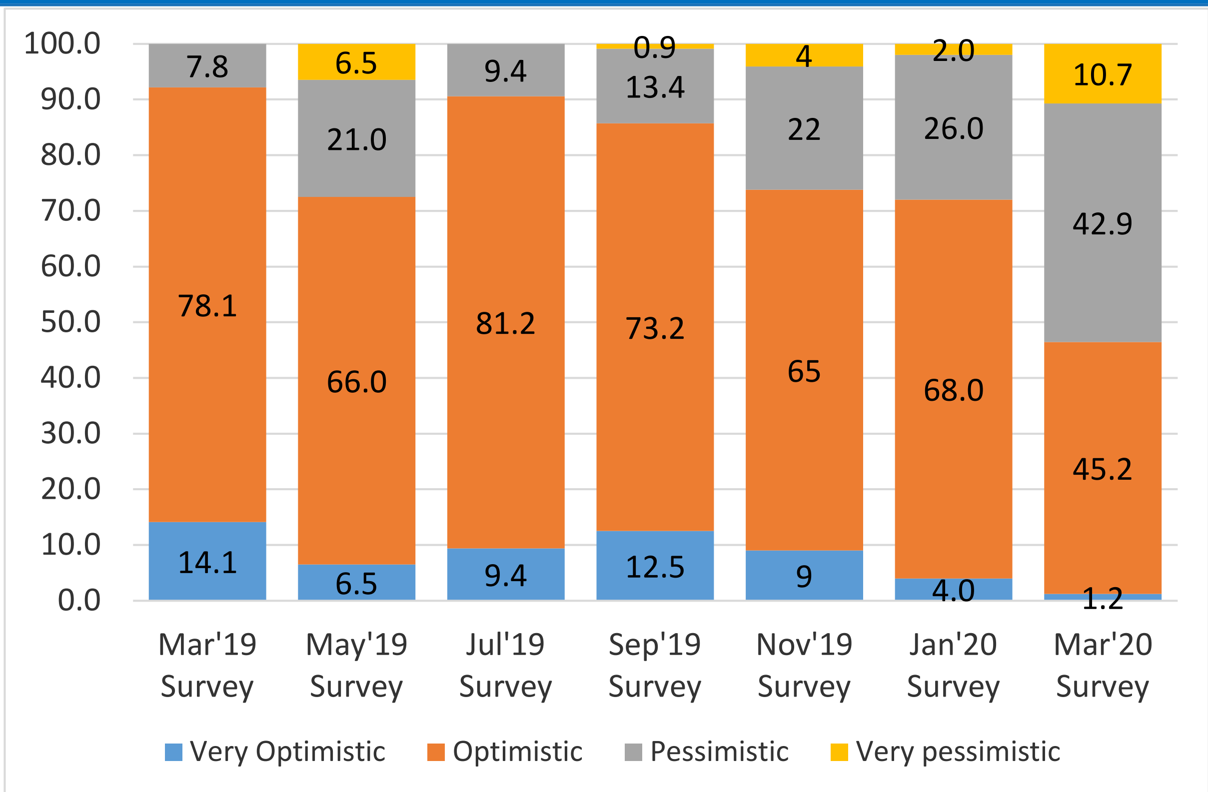


Chart 18: Optimism by Non-Bank Private Firms on Economic Prospects, Going Forward (percent)



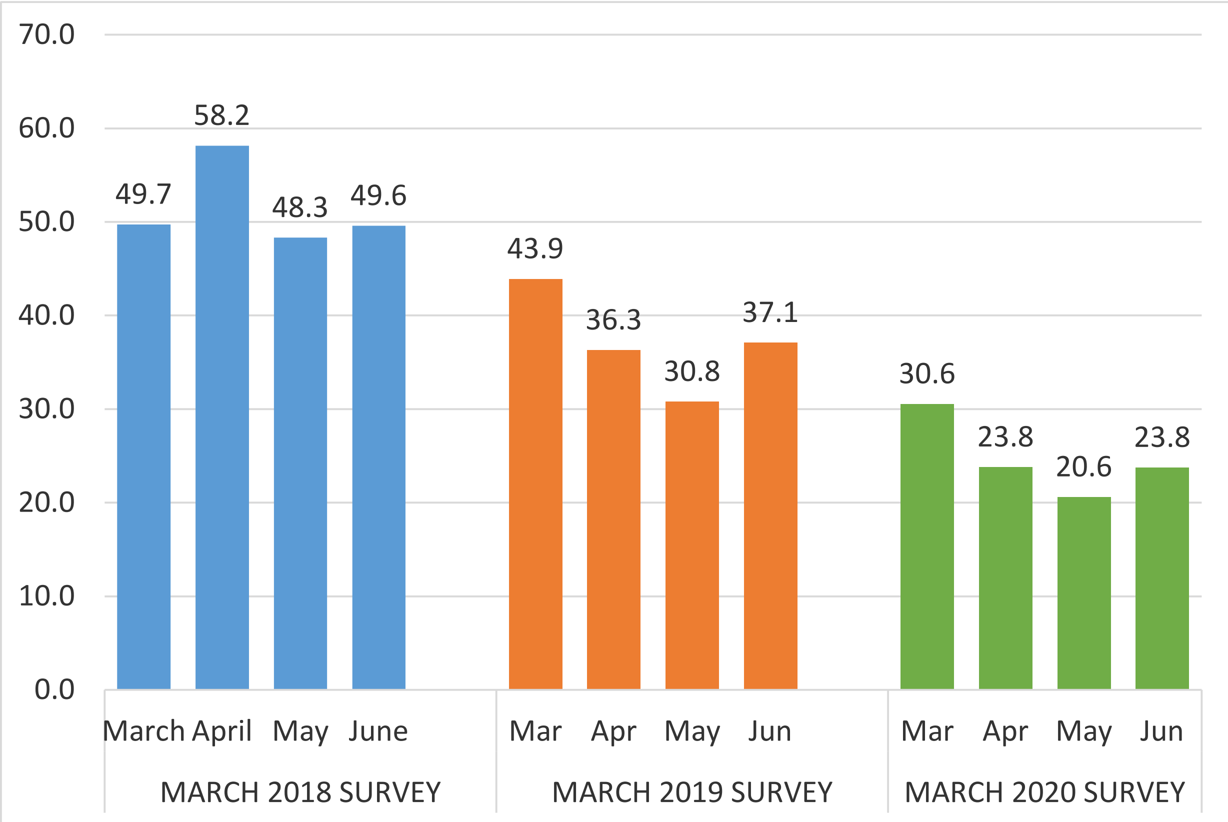
10.2. Forward Hotel Bookings

The March Survey requested hotel sector respondents to indicate monthly forward hotel bookings received so far for the period March – June 2020.

Forward hotel bookings for March to June were lower than in the previous 2 years, largely due to the lockdown resulting from banned international travel globally due to the COVID-19 pandemic **(Chart 19)**.

Hotel respondents indicated massive cancellations of bookings between March and May.

Chart 19: Forward Hotel Bookings for March–June 2020 (percent of total capacity)



11. SUGGESTIONS ON HOW THE BUSINESS ENVIRONMENT COULD BE IMPROVED

Banks and non-bank private firms were asked to indicate the challenges that they were currently encountering and suggest how the business environment could be improved, going forward.

Bank respondents indicated the need for coordinated fiscal and monetary policy to contain the COVID19 pandemic, fast-tracking approval of risk based pricing models, revision of guidelines on NPL provisioning to allow for moratoriums on impacted sector loans/mortgages, increased effectiveness in the judicial system on contract enforcement, implementation of Nairobi International Financial Centre and improved security to curb terrorism and cybercrime.

Other suggestions included the Government to consider re-opening the land registry to allow for perfection of securities and enable lending for pending secured credit lines that are impacted by the land registry closure, adjusting the requirements for advance tax payments e.g. deferring the installment taxes due in April, deferring payment of VAT, and ensuring pending bills are paid to SMEs on time.

The non-bank private firm respondents suggested that the Government should spare no effort in containing the coronavirus, reduce the cost of loans, ensure security in the country, reduce cost of production, reduce taxation and improve access to loans. Other suggestions included introduction of subsidies to cushion investors against losses beyond their control, prompt payment to suppliers, introduce tax incentives, restructuring foreign debt service and sustained fight against corruption.

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